No. 21,642

IN THE

United States Court of Appeals

For the Ninth Circuit

SONORA COMMUNITY HOSPITAL,
a California corporation,
Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

APPELLANT'S REPLY BRIEF

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I. APPELLANT'S CHARITABLE ACTIVITIES

The Respondent in this action apparently asserts that the term "charitable" as used in Section 501(c)(3) of the Internal Revenue Code has the same meaning as providing free services. The Appellant rejects this argument and contends once again that a hospital which provides accommodations and services for the sick and injured on a nonprofit basis is operated exclusively for charitable purposes within the meaning of Section 501(c)(3).

The extent of free services rendered must be entirely dependant on a source of income separate and apart from the services performed in the hospital.

Thus, County operated hospitals often render a considerable amount of free service because appropriations are made to them from General County tax revenues. Also, teaching hospitals may provide free service through clinics, etc., which are financed by endowments and government and private grants. Otherwise, the great majority of private tax-exempt hospitals must depend on charges made to their patients to meet their operating expenses.

It is an uncontroverted fact that Appellant had no endowment and no source of income other than the fees received for services rendered to its patients. For this reason it is apparent that Appellant would be in no financial position to provide free services in any large degree. If it did, either the operating expenses would not be met, or the paying patients would be required to pay excessive charges to cover the free services rendered.

This obvious conclusion is provided for in Rev. Ruling 185, 1956-1 Cum. Bul. 203 shown as Appendix C in Appellant's Opening Brief.

The Supreme Court of Nebraska in a recent decision referred to this same principle when it stated:

> "... the courts have defined 'charity' to be something more than mere alms-giving or the relief of poverty and distress, and have given it a significance broad enough to include practical enterprises for the good of humanity operated at a moderate cost to those who receive the benefits .... Hospitals operated as nonprofit institutions are universally classed as charitable institutions." *Evangelical Lutheran Good Samaritan*

Society v. County (1967) 151 N.W. 2d 446 (Nebraska).

The California State Revenue and Taxation Code Section 214 referring to the welfare exemption granted various organizations in the State of California specifically includes the word "hospital" along with "religious, scientific or charitable" in the qualifying organizations. (See Appendix A.)

It is true that the amount of free services provided was small in comparison to the gross business done, however, since no outside financial resources were available, one would hardly expect a larger portion of free services. Appellant did provide a reasonable amount of free or reduced charge services, and in an area most needed in the community. If a patient had limited insurance benefits or was otherwise ineligible for County Hospital care, and still unable to pay for medical treatments, then the Appellant accepted the patient on the basis of receiving partial payment. (Findings of Fact, p. 12; Tr. pp. 58-68 and 115-118.)

Thus within its limited ability Appellant did, in fact, furnish free or part pay services to those who needed it most.

It is difficult to imagine a more reasonable method of providing for such charitable community needs within the ability of Appellant and it is strongly urged that this argument of the Respondent be rejected.

II. PHYSICIANS' BENEFITS THROUGH PATIENTS BEING ADMITTED TO THE HOSPITAL.

The Respondent also contends that the founding doctors were benefited by having their patients treated in Appellant's facilities. Every hospital provides facilities in which physicians perform their services. This includes the surgeries, the delivery rooms, the patient wards, etc. This must be indeed a novel argument, because it is doubtful that any hospital in the world doesn't provide some indirect benefit to the physicians who practice there. Even interns and residents receive a certain amount of training in their profession and in every instance a hospital does provide its staff physicians with a place in which to treat their patients.

Appellant, again, strongly urges that this contention be rejected.

III. PAYMENTS TO THE FOUNDING PHYSICIANS BY THE SONORA LABORATORY AND X-RAY COMPANY.

It is submitted that the main and only substantial question in this action regards the cash payments made to the founding physicians by the Sonora Laboratory and X-ray.

It was Appellant's contention at the trial of this matter that even if the payments had been made to the founding physicians directly from hospital income, such payments were justified as proper compensation for services rendered. It is recognized that the Tax Court made a contrary finding. We contend that such a contrary finding is not substantiated by the evidence

presented at the trial and still persist in our belief that Dr. Boice and Dr. Anspach did perform services that would justify the compensation paid them, even if it had been paid directly from hospital income.

However, we do not believe that such a finding is necessary to sustain Appellant's contention.

Both by stipulation and finding of fact it is absolutely determined that the Rucker Brothers operated the Sonora Hospital Laboratory and X-ray Company as a completely separate business entity in partnership form. Therefore, all fees received by the Laboratory and X-ray Company belonged to and became the income of the Laboratory and X-ray Company and such fees were never at any time the income of Appellant.

Good reason existed for this arrangement between Appellant and the Laboratory and X-ray. In fact, no one has questioned the propriety of the Laboratory and X-ray operating a separate business entity and receiving the income from which it paid Dr. Boice and Dr. Anspach.

It is also uncontroverted that the money received by Dr. Boice and Dr. Anspach was paid from the income of the Sonora Hospital Laboratory and X-ray Company and not from the income of Appellant. Sonora Hospital Laboratory and X-ray was a profit-making taxpaying entity and as such could do with their income what they pleased. Their books and records showed the receipt of income as belonging to the Laboratory and X-ray and, of course, their

records showed the payments to Dr. Boice and Dr. Anspach.

The arrangement between the Laboratory and X-ray and Dr. Boice and Dr. Anspach was an arm's length transaction consummated even prior to the establishment of the Appellant's facilities.

The arrangement between the Appellant and the Laboratory and X-ray is not criticized and seems perfectly reasonable under the circumstances.

Thus, the simple, uncontroverted fact remains that the income received by the doctors and for which Appellant has been denied its tax-exempt status is not in any way the income of Appellant. Clearly no part of the net earning of Appellant inured to the benefit of any individual, and Appellant vigorously contends that the uncontroverted facts in no way should jeopardize Appellant's tax-exempt status.

IV. CONCLUSION

The Respondent again bases its claim for affirmation of the tax court decision by taking all the facts together, Appellant should be denied its tax-exempt status. This Appellant rejects. It appears that not one of the contentions made by the Respondent would deny Appellant its exempt status and it is argued that in the aggregate such contentions cannot be used to deny the exempt status.

For the above reasons and those contained in Appellant's Opening Brief, it is respectfully urged that

the decision of the Tax Court be reversed and that a decision be made holding that for the years in question Appellant was organized within the provision of Internal Revenue Code Section 501(c)(3) and that the revocation of the exempt status be annulled.

Dated, San Jose, California,
June 17, 1968.

Very respectfully yours,
ANDERSON AND MORGAN,
By ALVIN L. ANDERSON,
Attorneys for Appellant.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

ALVIN L. ANDERSON,
Attorney for Appellant.

(Appendix A Follows)

Appendix A

Appendix A

CALIFORNIA REVENUE AND TAXATION CODE SECTION 214

Property used exclusively for religious, hospital, scientific, or charitable purposes owned and operated by community chests, funds, foundations or corporations organized and operated for religious, hospital, scientific, or charitable purposes is exempt from taxation if:

(1) The owner is not organized or operated for profit; provided, that in the case of hospitals, such organization shall not be deemed to be organized or operated for profit, if during the immediate preceding fiscal year the excess of operating revenues, exclusive of gifts, endowments and grants-in-aid, over operating expenses shall not have exceeded a sum equivalent to 10 percent of such operating expenses. As used herein, operating expenses shall include depreciation based on cost of replacement and amortization of, and interest on, indebtedness;

(2) No part of the net earnings of the owner inures to the benefit of any private shareholder or individual;

(3) The property is used for the actual operation of the exempt activity;

(4) The property is not used or operated by the owner or by any other person so as to benefit any officer, trustee, director, shareholder, member, employee, contributor, or bondholder of the owner or

operator, or any other person, through the distribution of profits, payment of excessive charges or compensations or the more advantageous pursuit of their business or profession;

(5) The property is not used by the owner or members thereof for fraternal or lodge purposes, or for social club purposes except where such use is clearly incidental to a primary religious, hospital, scientific, or charitable purpose;

(6) The property is irrevocably dedicated to religious, charitable, scientific, or hospital purposes and upon the liquidation, dissolution or abandonment of the owner will not inure to the benefit of any private person except a fund, foundation or corporation organized and operated for religious, hospital, scientific, or charitable purposes;

(7) The property, if used exclusively for scientific purposes, is used by a foundation or institution which, in addition to complying with the foregoing requirements for the exemption of charitable organizations in general, has been chartered by the Congress of the United States (except that this requirement shall not apply when the scientific purposes are medical research), and whose objects are the encouragement or conduct of scientific investigation, research and discovery for the benefit of the community at large.

The exemption provided for herein shall be known as the "welfare exemption." This exemption shall be in addition to any other exemption now provided by law. This section shall not be construed to enlarge the

college exemption. Property used exclusively for school purposes of less than collegiate grade and owned and operated by religious, hospital or charitable funds, foundations or corporations, which property and funds, foundations or corporations meet all of the requirements of this section, shall be deemed to be within the exemption provided for in Section 1c of Article XIII of the Constitution of the State of California and this section.